

AMENDED IN SENATE FEBRUARY 10, 2015

SENATE BILL

No. 8

Introduced by Senator Hertzberg

December 1, 2014

An act to add Chapter 3.8 (commencing with Section 6305) to Part 1 of Division 2 of the Revenue and Taxation Code, relating to taxation.

LEGISLATIVE COUNSEL'S DIGEST

SB 8, as amended, Hertzberg. Taxation.

The Sales and Use Tax Law imposes a tax on retailers measured by the gross receipts from the sale of tangible personal property sold at retail in this state, or on the storage, use, or other consumption in this state of tangible personal property purchased from a retailer for storage, use, or other consumption in this state. The Personal Income Tax Law imposes taxes on personal taxable income at specified rates, and the Corporation Tax Law imposes taxes upon, or measured by, corporate income.

This bill would state legislative findings regarding the Upward Mobility Act, key provisions of which would expand the application of the Sales and Use Tax law by imposing a tax on specified services, would enhance the state's business climate—and, would incentivize entrepreneurship and business creation by evaluating the ~~Corporate Tax Law~~, *corporate tax*, and would examine the impacts of a lower and simpler ~~Personal Income Tax Law~~, *personal income tax*.

This bill would, on and after January 1, ____, expand the Sales and Use Tax Law to impose a tax on the gross receipts from the sale in this state of, or the receipt of the benefit in this state of services at a rate of ____%.

Vote: majority. Appropriation: no. Fiscal committee: no.
State-mandated local program: no.

The people of the State of California do enact as follows:

- 1 SECTION 1. The Legislature finds and declares all of the
2 following:
- 3 (a) California has long been known as the land of opportunity,
4 the republic of the future. But for too many of its residents the
5 future is receding. Inequality continues to rise — even though
6 California has one of the most progressive tax structures in the
7 nation.
- 8 (b) Something more is needed; a new philosophy of governance
9 that focuses on the overall progressive outcome that can be
10 achieved through modernizing our tax system and investing in the
11 means of upward mobility, above all job creating infrastructure
12 and public higher education for our increasingly youthful
13 population.
- 14 (c) Beyond these foundations, building and sustaining a middle
15 class means new jobs with good wages. Small businesses, like
16 plumbing contractors, auto repair shops, and restaurants that
17 account for over 90 percent of the state's businesses and well over
18 a third of all jobs, are a key rung on the ladder of upward mobility.
19 They need a tax policy that will enable them to grow and add
20 employees.
- 21 (d) California's two trillion dollar economy has shifted from
22 being mainly agricultural and manufacturing in the 1950s and
23 1960s, when the framework of today's tax system was set, to one
24 based on information and services, which now accounts for 80
25 percent of all economic activities in the state. To achieve a future
26 as promising as California's past, we need a tax system that is
27 based on this real economy of the 21st century while ensuring that
28 new revenue is invested in strengthening the ladder of mobility
29 for all our residents.
- 30 (e) California of the 1950s and 1960s was governed with an eye
31 towards the future and was renowned for the opportunities that it
32 created for its residents. California's water system was born during
33 that era and transformed the desert into fertile agricultural land
34 that not only fed Californians but the world. California also
35 constructed its freeway system to more rapidly and safely move

1 people and goods through the state as California became the
2 gateway to the Pacific Rim. California's higher education system
3 was the envy of all, reaching new heights as the University of
4 California and the California State University grew by six and
5 eight campuses respectively between 1958 and 1965. California's
6 investment in infrastructure and education paid off as agriculture,
7 aerospace, and then technology boomed and drove California into
8 the 21st century as the fifth largest economy in the world. As
9 businesses thrived, they created an abundance of middle class jobs
10 that enabled Californians to capitalize on new opportunities to
11 better the standard of living for themselves and their families.

12 (f) As California's economy thrived, however, its eye on the
13 future wavered. By the late 1970s, state and local finances became
14 intertwined; the state increasingly used its funds to support
15 traditionally local operations and both state and local governments
16 pulled back on the types of investments needed to help businesses
17 and residents succeed. Today, Californians live with the
18 investments made more than three generations ago. Fifty-five
19 percent of our local streets need to be repaired or replaced. While
20 the state's water system received some funding in 2014, more is
21 needed to meet the state's demands.

22 (g) On a local level, 70 percent of Los Angeles' water
23 infrastructure is composed of cast-iron pipes, most of which was
24 laid during the early half of the 20th century.

25 (h) Our financial commitment to kindergarten and grades 1 to
26 12, inclusive, education has waned. Average Daily Attendance
27 grew anemically by 0.06 percent annually between 2007 and 2011.
28 By 2011, California ranked 43rd in per pupil spending and
29 California's ADA was \$2,580 less than the United States average
30 — the largest gap in 40 years.

31 (i) California's commitment to higher education has also
32 receded. In addition to opening professional and economic
33 doorways for students, California's higher education system is one
34 of our most important economic engines. With almost 60 faculty
35 and researchers who have won the Nobel prize, the University of
36 California has over 3,200 active patents and contributes \$33 billion
37 to the California economy annually. The California State University
38 generates an additional \$17 billion in economic activity and
39 supports 150,000 jobs in the state. Despite its proven value,
40 California has not been able to maintain higher education

1 accessibility for its residents. In the past 20 years, University of
2 California fees have increased by 434 percent and California State
3 University fees by 300 percent. Moreover, California community
4 colleges, the largest provider of workforce training in the nation,
5 increased fees by 130 percent between 2008 and 2012, leading to
6 over a 20 percent decline in enrollment.

7 (j) The lack of investment in infrastructure and education has
8 diminished opportunities for Californians and continues to fuel
9 the growing income inequality in California. Since 1970, the
10 poorest 20 percent of Californians have seen their household
11 income grow by just 3.1 percent while the income of the richest
12 20 percent has climbed 74.6 percent. Since 1987, 71.3 percent of
13 all the gains generated by California's economy have gone to the
14 state's wealthiest 10 percent. Moreover, today, California accounts
15 for three of the 10 American cities with the greatest disparities in
16 wealth—San Francisco, Oakland, and Los Angeles.

17 (k) (1) The Upward Mobility Act would help ensure California's
18 residents and businesses can thrive in the 21st century global
19 economy by increasing funding by \$10 billion dollars for the
20 following programs, as the revenue becomes available:

21 (A) Three billion dollars to K-14 education. Investing in its
22 residents through education is the foundation on which California
23 has always built its economy. This measure would provide new
24 funds to help rebuild California's education system at every level.
25 The new revenues will help to rebuild classrooms and be available
26 to help protect classroom spending from pending pension fund
27 demands.

28 (B) Two billion dollars to the University of California and the
29 California State University. Similarly, the measure would restore
30 investment in California's prized higher education system, essential
31 to upward mobility for Californians. Revenues would be split
32 evenly between the University of California and the California
33 State University.

34 (C) Three billion dollars to local governments. Investing in local
35 governments will more closely connect Californians to the
36 government spending that occurs on their behalf and support the
37 new realignment burdens on local government. Moreover,
38 additional guaranteed funding to provide additional public safety,
39 parks, libraries, or local development, will allow local governments
40 to best meet the specific needs of their particular communities.

1 (D) Two billion *dollars* for a new earned income tax credit for
2 low-income families. The Upward Mobility Act would establish
3 a refundable earned income tax credit to help low-income families
4 offset the burden of the proposed sales and use tax on services.

5 (E) Small business and minimum wage relief. This measure
6 would enhance the state's business climate, create jobs, and
7 incentivize entrepreneurship by evaluating the current corporate
8 income tax to determine whether it is meeting its intended purpose
9 while at the same time linking changes to a more reasonable
10 minimum wage.

11 (2) Because this funding would be guaranteed, school districts,
12 community colleges, the California State University, the University
13 of California, and local governments would be able to securitize
14 the revenues to make essential long-term investments, just as is
15 the case with real property taxes.

16 (I) The Upward Mobility Act will fund these programs to enable
17 the upward mobility of our residents and to help make California's
18 businesses more competitive by modernizing our tax code. The
19 underlying problem is, while California's economy has evolved,
20 its tax system failed to keep up with the times. Over the past 60
21 years, California has moved from an agriculture and manufacturing
22 based economy to a services based economy. As a result, state tax
23 revenues have become less reliant on revenues derived from the
24 Sales and Use Tax on goods and more reliant on revenues derived
25 from the Personal Income Tax. In 1950, the Sales and Use Tax
26 comprised 61 percent of all state revenues; today, it accounts for
27 about 30 percent. The Personal Income Tax accounted for 12
28 percent of total state revenues in 1950; today, it accounts for more
29 than 60 percent.

30 (m) Moreover, California's General Fund tax collections are
31 heavily dependent on the earnings of its top earners. This has led
32 to dramatic revenue swings year over year. During the dot-com
33 economic boom of the ~~1950s~~ 1990s through the early part of the
34 21st century, state revenues soared by as much as 20 percent in a
35 single year. However, as personal incomes tumbled during the
36 Great Recession, state revenues plummeted disproportionately.
37 These swings in revenue have led to the suffering of California's
38 residents. Essential services, such as health care and child care for
39 low-income families, were cut at a time when they were needed
40 most. In addition, the state cut billions of dollars to education,

1 including adult vocational and literacy education, which could
2 have helped low-income families recover from the recession.
3 Relying on the wealthiest taxpayers to support California's needs
4 is outdated and dangerous fiscal policy. Not only does it increase
5 the uncertainty of tax collections, but there is evidence that
6 California's high tax rates may be driving high income earners out
7 of the state, which only deepens revenue shortfalls.

8 (n) The economy has shifted away from the production of goods
9 to services. Since 1966 sales of taxable goods, as a share of the
10 economy, have been cut in half. Today services represent 80
11 percent of California's economy. Expanding the Sales and Use
12 Tax to cover services removes a significant inequitable aspect of
13 the tax code, implicitly favoring consumer spending on services
14 over goods. Currently the sale of a TurboTax software disk is
15 taxed, whereas a consumer who instead paid H&R Block would
16 escape taxation. In essence, those who produce goods such as
17 software or machinery are supporting those who produce services
18 and information. Taxing only goods and not services when our
19 economy has been so fundamentally transformed makes no sense
20 and is manifestly unfair. This has to change.

21 (o) The Upward Mobility Act seeks to make three broad changes
22 to the tax code:

23 (1) Broaden the tax base by imposing a sales tax on services to
24 increase revenues. Local jurisdictions would not be authorized to
25 increase sales tax on services, as they now can do with the sales
26 tax on goods. Though the new revenues would be collected by the
27 state, the ownership of those funds allocated to local government
28 under this measure will be controlled by local government using
29 traditional allocation mechanisms. Health care services and
30 education services would be exempted from the tax, and very small
31 businesses with under \$100,000 gross sales would be exempted
32 from the sales tax on services.

33 (2) Enhance the state's business climate and incentivize
34 entrepreneurship and business creation by evaluating the corporate
35 income tax to determine whether it is meeting its intended
36 purposes, including whether it is ~~born~~ *borne* equitably among
37 California's businesses and what impact it has on the business
38 climate, while at the same time linking changes to a more
39 reasonable minimum wage.

(3) Examine the impacts of lowering and simplifying the ~~Personal Income Tax~~ *personal income tax* while maintaining progressivity. The measure's goal is to reduce the ~~income tax rates imposed under the Personal Income Tax~~ *personal income tax rates* for low-and middle-class-income households so that families earning \$100,000 pay only \$1,000. The income tax rate for top earners may also be reduced in a manner that balances fairness with mitigating adverse impact to both state revenues and competitiveness. The obligation of top earners with regard to other tax obligations for top earners, including Proposition 63, would remain intact.

(p) In order to ensure fiscal responsibility, the Upward Mobility Act's revenue reduction provisions would be phased in only when it is clear that new revenues are sufficient to replace any revisions to the personal income tax and corporate tax.

(q) As the revenues secured by Proposition 30 expire, California policy decisionmakers must determine new long term ways to provide for state residents. The Upward Mobility Act will increase opportunities for California's businesses and create an upward mobility ladder for California residents. Moreover, the Upward Mobility Act will realign the state's outdated tax code with the realities of California's 21st century economy.

SEC. 2. Chapter 3.8 (commencing with Section 6305) is added to Part 1 of Division 2 of the Revenue and Taxation Code, to read:

CHAPTER 3.8. SERVICES

6305. In addition to the taxes imposed by this part, for the privilege of selling services at retail a tax is hereby imposed upon all retailers at the rate of ____ percent of the gross receipts of any retailer from the sale of all services sold at retail in this state on or after January 1, ____.

6306. In addition to the taxes imposed by this part an excise tax is hereby imposed on the receipt of the benefit of the service in this state of services on or after January 1, ____, at the rate specified in Section 6305 of the sales price of the services.